

March 21, 2005



Honorable Mayor and City Council:

The 2005/06 Proposed Budget reflects continuing strength in the City's economy, reinforced by positive trends at the state and national levels. Modest improvements projected in the City's revenues, combined with savings carried over from the 2004/05 fiscal year, will allow Scottsdale to balance its budget, meet its most pressing needs and fund the City's highest priorities for the 2005/06 fiscal year. These needs include a new municipal fire department, additional police officers, added operating costs related to the opening of new City facilities, a continued focus on code enforcement and property maintenance in the mature portions of the City, and continued emphasis on economic vitality and revitalization.

With improved economic conditions, the City has an opportunity to address programs not funded in recent budgets. At the same time, our long-range financial outlook requires us to remain conservative and focus only on the highest Council and citizen priorities. All areas of the City have pent-up demands, and it is not possible to address them all.

The revenue forecasts used in this budget, like last year's, are cautiously optimistic. The staff has not assumed that the City has returned to the extraordinary economic conditions of the 1990s. The City is past its historic period of peak expansion and our long-term budget plans must recognize that fact.

The budget also takes a conservative approach to revenues resulting from economic development and revitalization. As we look at the level of public and private investment in our community, it is clear the economy of Scottsdale continues to hold great promise. However, it is difficult to project exactly when the City will realize the benefits of these investments through increased revenues. Therefore, the forecasts reflected in this budget do not factor in possible future revenues from new or planned projects. The fiscally prudent and responsible course is to exclude proposed revenue generators until they have opened or are close to opening.

The overall uncertainty surrounding the magnitude and sustainability of the economic recovery requires us to remain vigilant as we monitor and manage the City's fiscal matters in the coming year.

In planning for expenditures, the City staff continued to use a zero-based, "program budget" approach. The program budget focuses on the total cost and quality of each service citizens receive, whether one department or several provide the service. The staff also continued to develop a more realistic and precise plan for continued investment in the City's basic infrastructure and public facilities, combined with a more comprehensive analysis of maintenance and operating costs.

As in years past, the main focus of the proposed budget is the General Fund, the City's largest fund, which supports basic services. Under the proposed budget, General Fund expenditures, debt payments and transfers-out to other funds will increase \$27.4 million, from the current fiscal year-end forecast of \$228.5 million to \$255.9 million. The increase in the proposed budget is funded by a combination of the new Public Safety Sales Tax, approved by voters in May 2004 for enhanced public safety services, and increased revenues expected from an overall improvement in the state and local economies.

Highlights of the proposed General Fund budget include the following:

New staff positions to address high priority needs such as public safety, revitalization, code enforcement, youth activities and after school programs, planning, and parks and recreation.

The General Fund budget proposes an addition of approximately 119 full-time equivalent positions (FTEs) at an estimated net cost of \$3.2 million. Included in the total are 9 FTEs proposed to be converted from current contract worker positions to regular City employee positions next year. The costs associated with these converted positions will remain essentially unchanged from the current budget year.

Most of the new positions are front-line employees who will provide direct services to citizens or provide basic support services for the staff serving the public.

The table below provides an overall summary of the new staff proposed in the General Fund, classified by five broad areas of need:

- **Staffing for new or expanded City facilities**, mainly funded by voter-approved bonds, which are scheduled to open in the coming year. These include a new sports complex, senior center and aquatics center.

- **Public safety positions, a significant number of them funded through the voter-approved public safety tax.** These include increases in the number of patrol officers and other personnel to improve police services.
- **Staff needed to continue the City's emphasis on revitalization.** These positions include downtown maintenance workers and code enforcement inspectors.
- **Sufficient staff to meet customer service needs** in such areas as after-school programs for youth, processing of utility payments and compliance with Americans with Disabilities Act requirements.
- **Staff to meet "internal" service demands.** These are positions in the legal, financial and information systems areas that support the day-to-day needs of other operating departments.

Service Category	Gross Cost	Offsets	Net Cost	New FTEs	Contract Worker Offsets	Net FTEs
Community Facilities	\$0.7M	n/a	\$0.7M	42.45	n/a	42.45
Public Safety	\$1.4M	n/a	\$1.4M	46.00	n/a	46.00
Revitalization	\$0.7M	(\$0.2M)	\$0.5M	16.00	(5.00)	11.00
Citizen Services & Community Growth	\$0.4M	(\$0.1M)	\$0.3M	9.46	(3.00)	6.46
Internal Service Demands	\$0.3M	(\$0.0M)*	\$0.3M	5.00	(1.00)	4.00
Totals	\$3.5M	(\$0.3M)	\$3.2M	118.91	(9.00)	109.91

*Amount less than \$100,000

More detailed descriptions of the positions added in each area are provided under the General Fund summary later in this transmittal letter, and in a supplement at the end of the introductory section of the budget.

Employee compensation. Under the proposed budget, most employees would receive a cost-of-living adjustment of 3.5 percent, at a total cost of \$3.9 million. The compensation proposal widens the current pay ranges (the difference between the minimum and maximum) from the current 35 percent to 45 percent for several pay ranges. This change will allow the City's pay ranges to remain competitive. Employees would need to earn any pay increases in the expanded range through job performance. Additionally, the City will not incur increased per capita healthcare costs in the coming year. The City's implementation of self-insured health plans and cost containment measures more than a year ago has controlled health care costs.

Retirement costs. Based on an increase in the statutorily mandated contribution rate, the City's contribution to the Arizona State Public Safety Retirement System for police in FY 2005/06 increases by about \$0.8 million. The rate for sworn police and fire employees is statutorily capped at 7.65 percent, and police officers will not face an increase next year. The City will also pay approximately \$1.8 million in FY 2005/06 to the Public Safety Retirement System on behalf of firefighters as part of the first-year operating costs for the new municipal fire department. The City's contribution to the Arizona State Retirement System for civilian employees will increase by about \$1.8 million in FY 2005/06. Under state law, the City and the civilian employees each contribute equally to the retirement system. For FY 2005/06 the rate paid by the employer and employee increases by 2.55 percentage points from 5.70 percent to 8.25 percent of the civilian employee's annual compensation. The 8.25 percent contribution rate will remain in effect through FY 2006/07.

Capital Improvement Plan

A separate, key component of the annual financial plan is the City's five-year Capital Improvement Plan (CIP) for infrastructure and public facilities – including roads, water and sewer improvements, parks, buildings and information technology. The total proposed CIP appropriation for FY 2005/06 is \$899.7 million, which includes \$415.8 million (or 46.2 percent of the total) re-budgeted from the prior year. Under Arizona law, the City must rebudget for a capital project until it is completed.

Many of the projects listed in the capital budget are funded by a combination of sources such as the City's transportation sales tax, Bond 2000 funds, user fees, grants, the Proposition 400 regional transportation sales tax, the City's preservation sales tax, development impact fees and General Fund transfers. The proposed FY 2005/06 General Fund transfer into the Capital Project Fund of \$32.7 million consists mainly of one-time funds realized in the current fiscal year. Based on adopted financial policies, the City has prudently used one-time "elastic" revenue (e.g., construction sales tax and development fees) in excess of the adopted operating budget for future capital project funding. Municipal bond rating agencies view the practice of using one-time funds for capital projects as a sound fiscal practice.

Geographically, the capital projects are spread throughout the community, with 25 percent north of Indian Bend Road, 30 percent south of Indian Bend, 21 percent citywide and 24 percent in the McDowell Sonoran Preserve. Additionally, 73 percent of the capital budget projects relate to work on new facilities and 27 percent relates to renovation of community facilities.

Highlights of the proposed capital budget by major project area, along with examples of notable capital projects in each project area, are provided below:

Examples of priority projects	(In millions)		
	Rebudgets	New	Total
Community Facilities <ul style="list-style-type: none"> ▪ Civic Center Library Improvements ▪ Vista Del Camino – Yavapai Ballfields ▪ Grayhawk Community Park ▪ Spring Training Facility ▪ Scottsdale Center for the Performing Arts Renovation ▪ Construction of WestWorld Multi-Purpose Building 	\$108.1	\$61.1	\$169.2
Preservation <ul style="list-style-type: none"> ▪ Construction of the Trails Supporting the Gateway to the Preserve ▪ Expanded McDowell Sonoran Preserve ▪ Lost Dog Wash Access Area 	\$34.4	\$182.8	\$217.2
Drainage & Flood Control <ul style="list-style-type: none"> ▪ TPC Drainage Improvements ▪ Indian School Road Drainage ▪ Pima Road Drainage ▪ North Scottsdale Road Corridor Drainage ▪ Upper Camelback Wash Watershed 	\$19.5	\$10.0	\$29.5
Public Safety <ul style="list-style-type: none"> ▪ Fire Station South Quadrant ▪ Fire Station #813 – Via Linda Expansion ▪ District 1 Police Facilities 	\$47.1	\$19.5	\$66.6
Service Facilities <ul style="list-style-type: none"> ▪ North Marshall Way Garage ▪ South Canal Bank Public Parking Garage ▪ Community Services Facility Maintenance 	\$23.1	\$20.5	\$43.6
Transportation <ul style="list-style-type: none"> ▪ Indian Bend Road - Scottsdale to Hayden ▪ Indian School Road – Drinkwater to Pima Freeway ▪ Scottsdale Road – Frank Lloyd Wright to Thompson Peak Parkway ▪ Thompson Peak Parkway – Bell to Union Hills ▪ Hayden Road North of Loop 101 to Thompson Peak Parkway ▪ ASU Scottsdale Center Transit Passenger Facility ▪ Bus Stop Improvements ▪ McDowell Road Bicycle and Pedestrian Improvements ▪ Thomas Road Bicycle Lane and Enhanced Sidewalks 	\$81.1	\$67.1	\$148.2
Water Services <ul style="list-style-type: none"> ▪ CAP Plant Expansion ▪ CAP Plant Regulatory Compliance ▪ Arsenic Mitigation Facilities for the City's Water System 	\$102.5	\$122.9	\$225.4
Totals	\$415.8	\$483.9	\$899.7

Each year the City staff continues to enhance the project evaluation and cash management processes to prioritize and propose funding for projects. The proposed five-year CIP uses conservative financial forecasts and reflects only those projects with the highest priority and most realistic expectation for completion during the next five years. This approach avoids raising expectations for projects that are not well defined or that the operating budget will not support.

The improvements in managing CIP finances are helping the City to manage transfers from the General Fund for capital funding purposes. In FY 2005/06 the budget assumes transfers from the General Fund

into the CIP of approximately \$32.7 million. Of this total amount, \$3.2 million will go to general maintenance, \$4.2 million will go to public safety radio replacements and the remaining \$25.3 million will support the overall CIP program. The significant increase in General Fund revenues flowing into the Capital Improvement Fund will help the City fund key capital projects now and ensure the City is well positioned in coming years to draw on its capital funding when Scottsdale must meet its commitments to build infrastructure at the ASU Scottsdale Center for New Technology and Innovation.

As in recent years, the City continues to face a quandary in capital funding plans. An extremely favorable bond market currently makes debt financing very attractive. At the same time, the City has finite resources to fund operating costs for many of the proposed capital projects. As Scottsdale begins to move forward with economic recovery, the proposed five-year CIP attempts to continue – and even expedite – priority projects while ensuring long-term funding sustainability for operating impacts.

The proposed budget would affect citizens and taxpayers in the following ways:

The property tax rate will continue to drop. For the eighth consecutive year, the City's estimated combined property tax rate will drop. For FY 2005/06 the combined property tax rate will decrease by 6 cents from \$1.07 to \$1.01 per \$100 of assessed valuation. This is 49 cents, or 33 percent, below the City's \$1.50 financial policy limit initiated with the Bond 2000 authorization. The overall effect of the lower tax rate on tax bills depends on changes in the assessed valuation of each property. The lower tax rate stems from a combination of rising assessed valuations and effective debt management. The City uses a balanced mix of long-term debt and pay-as-you go funding to "smooth" the overall tax burden and help ensure taxpayers who will use City facilities today and those who will use them in the future contribute equitably for their costs.

Utility charges will rise marginally. The average homeowner's combined bill for water, sewer, refuse, and recycling services will increase an average of about \$1.62 per month if a proposed three-tier water rate structure is adopted to further promote water conservation efforts. Since the additional 3rd tier is designed to increase charges for the highest users, customers who use lower or average amounts will be less affected. If the current two-tier structure is retained, the average homeowner's bill increase will be higher. Federal health and environmental requirements are a significant factor in water rate increases. They are the primary reason for several major capital projects, including upgrades to the CAP Treatment Plant and arsenic mitigation facilities.

Budget timing and state legislation

This proposed budget does not account for any potential legislative changes that could adversely affect the final FY 2005/06 budget or future year financial forecasts for the following items:

State-Shared Revenues – any proposed modifications to the allocation of state-shared revenues to local jurisdictions. The budget does assume, under the current allocation of share revenues, that the mid-decade Census will adversely affect the City's state-shared revenues by an estimated \$2.0 million beginning in FY 2006/07. Faster-growing cities and towns within the state receive an increased proportion of the overall pool of state-shared revenues.

Property Tax Assessments – any proposed modifications to the commercial and residential property tax assessment structure that could affect the City's final 2005/06 budget or future year financial forecasts.

Photo Enforcement – any proposed changes that could negatively impact revenues and operating expenses for the city's Photo Enforcement Program.

The staff will continue to monitor the state's budget proposals and assess the impact of any proposed changes on the City.

Components of the Proposed Budget

This transmittal letter is intended to provide the City Council with a broad overview of the proposed budget, key changes and issues and recommendations for changes in the City's Financial Policies. As noted above, it focuses mainly on the General Fund. This fund provides the core services available to all citizens, and therefore warrants the most attention during the budget review process.

The proposed budget includes balanced five-year financial plans for each of the City's funds, emphasizing long-term fiscal planning. The budget also includes individual budgets for the City's more than 180 programs. The goal of the program budget is to provide the City Council, citizens, and other stakeholders a more focused analysis of the costs of each City service or function, whether the service is provided by one department or through the combined efforts of several areas. Each program budget includes a program description, services provided, City Council Goals supported by the program, a multi-year summary of

budget and staffing, customers, program goals and objectives and performance measures. The proposed budget also includes a detailed summary of the proposed FY 2005/06 capital budget.

The following is a summary of budget highlights by fund.

General Fund Revenues

The General Fund supports core services and is the largest fund with the greatest potential for revenue fluctuations. General Fund revenue estimates in the proposed budget are conservative. This is the prudent and most accountable approach for the long-term fiscal interest of the City.

Total General Fund revenues and transfers-in are expected to increase approximately \$9.6 million or 4.1 percent, from the FY 2004/05 year-end forecast of \$235.1 million to \$244.7 million in FY 2005/06. The following General Fund revenues represent the most significant changes between fiscal years:

Transaction Privilege Tax, or "Sales Tax" – Scottsdale's total City sales tax rate is 1.65 percent. Of that amount, .65 percent is dedicated to the specific purposes of transportation, preservation and public safety. These revenues and their uses are explained later in this transmittal. The remaining 1.0 percent sales tax goes to the General Fund and is available for any municipal purpose. This 1 percent general-purpose sales tax is the City's single largest revenue source. It is projected to increase an estimated 4.1 percent, or \$3.8 million, to \$96.7 million in FY 2005/06. It is considered an "elastic" revenue source susceptible to peaks and valleys, based on events in the national, state and local economies. Beyond FY 2005/06, the five-year financial plan projections reflect a stable 4.0 percent increase in sales taxes – essentially keeping pace with a projected modest inflation rate.

Transaction Privilege Tax - Public Safety – These revenues are drawn from a 0.1 percent sales tax approved by voters in May 2004 and designated for public safety. This revenue is projected to increase by 24.3 percent, or \$1.9 million, to \$9.7 million in FY 2005/06. The large percentage increase between years is attributable to 11 months of tax collections in FY 2004/05, the initial year of the tax, compared to 12 months in FY 2005/06. Beyond FY 2005/06, the five-year financial plan projections also reflect a stable 4.0 percent increase, keeping pace with inflation.

Property Taxes – This revenue source is one of the few stable General Fund revenues and is anticipated to increase by \$1.1 million, or 6.1 percent over FY 2004/05, to \$18.7 million. The increase in revenue is driven by a combination of growth in existing property assessment values, up 5.3 percent, and new construction, up 4.2 percent. The estimates for FY 2005/06 and beyond do not factor in any potential reductions resulting from legislative changes that may result from proposed modifications to the commercial and residential property tax assessment structure.

Transient Occupancy Tax, the Hotel "Bed Tax" – This revenue source is expected to increase to nearly \$8.2 million, for an increase of \$0.3 million, or 3.5 percent, from the FY 2004/05 year-end forecast of \$7.9 million. Like sales taxes, these revenues are less predictable because of ongoing uncertainty in the economy and the magnified effects of potential acts of terrorism on business and pleasure travel. While Scottsdale remains an internationally known destination for travelers, the City is seeing growing competition in the Valley, the nation and abroad. This budget forecasts moderate growth in this revenue source in FY 2005/06 and beyond.

State-Shared Revenues, or "Intergovernmental Revenues" – These revenues are projected to increase about \$2.9 million or 7.9 percent, from \$36.6 million in FY 2004/05 to \$39.5 million in 2005/06. These revenues are from state sales and income taxes shared with Arizona cities and towns, based on a statutorily determined formula. The shared sales tax revenue projection is based on a modest statewide economic recovery. The shared income tax revenue projection reflects a two-year lag between the time citizens file their state taxes and the date the revenues are sent to cities and towns. As noted above, these two estimates do not factor in any potential reductions resulting from legislative changes in FY 2005/06 and beyond. However, the General Fund five year financial plan does assume the mid-decade census will adversely impact the City's state-shared revenues by an estimated \$2.0 million in FY 2006/07, as faster growth cities and towns within the state receive an increased proportion of the overall pool of state-shared revenues.

Development Permits and Fees – This revenue is expected to decrease, following an extraordinarily strong performance in FY 2004/05. At \$15.5 million in FY 2005/06, the forecast assumes revenues will be more in line with normal market conditions. This unpredictable revenue source can have dramatic peaks and valleys from year to year. The staff foresees a slight slowdown in development and construction during the coming fiscal year and beyond as Scottsdale approaches build-out. The forecast assumes, as the City continues its revitalization efforts, that revenues from home remodels and rehabilitation projects will become a larger share of development and permit fee revenues compared to new home construction.

Fines and Forfeitures – This revenue source includes court fines, parking fines, Photo Enforcement Program revenues, and library fines, which in the aggregate are anticipated to increase approximately \$0.4 million or 4.7 percent over the projected 2004/05 year end amount of \$8.0 million to \$8.4 million in FY 2005/06. As previously noted, the Photo Enforcement revenue does not factor in any potential reductions resulting from legislative changes in FY 2005/06 and beyond.

General Fund Expenditures

Under the proposed budget, General Fund expenditures, debt payments and transfers-out of the fund increase by \$27.4 million in FY 2005/06 to \$255.9 million, or 12.0 percent, from the forecasted FY 2004/05 year-end amount of \$228.5 million. A major component of the increase is a \$25.3 million transfer out to the capital project fund. The most noteworthy changes in the General Fund expenditures and transfers-out were outlined in the first section of this transmittal letter. Additional details on new positions and on selected expenditures are provided below:

New Staff Positions – As a general rule, most of the new positions assume a hire date of September 1 or later. Many hire dates are staggered throughout the fiscal year, when possible, to minimize the initial year fiscal impact. The proposed budget includes new staff in the four service categories noted below:

- Community Facilities – The positions in this category are necessary to staff new facilities constructed with voter-approved Bond 2000 funding. The proposed budget includes 42.45 FTE new positions at approximately \$0.7 million in payroll and benefits costs associated with the opening of three facilities. The CAP Basin Sports Complex will require 11.60 FTEs to support the fall 2005 opening. The new McDowell Village Senior Center scheduled to open in November 2005 will require 5.85 FTEs due to the increased size of the facility and demand for services. In the later part of FY 2005/06, the McDowell Mountain Ranch Park and Aquatic Center will require 21.00 FTEs in advance of the anticipated July 2006 opening. The Facilities Maintenance Program will also require 4.00 FTEs to handle the added facilities.
- Public Safety - All of the proposed staff additions in this category are Police Department positions. The proposed budget includes 46 FTE General Fund positions at \$1.4 million in payroll and benefits costs. They include a combination of sworn (24.00 FTEs) and civilian (22.00 FTEs) positions. The largest public safety increases included in the proposed budget are in the following areas: Patrol (20.00 FTEs sworn and 7.00 FTEs civilian), Detention Officers (8.00 FTEs civilian), and Police Records (5.00 FTEs civilian). Additional sworn positions (4.00 FTEs) are proposed to handle increased training, recruiting and internal affairs duties related to the increase in police officers. The budget includes additional civilian positions (2.00 FTEs) to address property and evidence, and police supplies and equipment. The City Council in 2004 approved enhanced staffing levels for the Fire Department, including a fourth firefighter on most trucks and 56-hour work weeks. These staff levels are reflected in this budget. The public safety enhancements to police and fire are funded from the new Public Safety Sales Tax. Funding from this source, totaling \$9.7 million, covers approximately 10.3 percent of the total proposed police and fire operating budgets of \$94.1 million.
- Revitalization – The positions in this category provide services such as litter pick-up, painting, and alley and landscape maintenance related to the City's revitalization work in the downtown and southern Scottsdale areas. The proposed budget includes 16.00 FTE positions at a net payroll and benefits cost of approximately \$0.5 million. The positions in this category include 5 contract or temporary positions that will be converted to City positions and 7.00 FTEs to replace City staff who were redeployed from other positions and are currently performing these services. The budget also includes code enforcement (3.00 FTEs) and an additional staff position for downtown maintenance (1.00 FTE) to enhance revitalization work in the area.
- Customer Services and Community Growth – The need for positions in this category stems from customer service demands, growth in the community, and federal requirements such as the American with Disabilities Act (ADA). The proposed budget includes 9.46 positions at a net payroll and benefits cost of approximately \$0.3 million. The budget includes growth-related staff for the Youth Activities and After School programs (3.46 FTEs) to address a growing waiting list for services. It also includes positions for the Revenue Recovery (1.00 FTE) and Remittance Processing (1.00 FTE) programs to maintain customer service levels. The budget includes a new staff position in the Planning and Development Services Department (1.00 FTE) to centralize the City's management of and compliance with federal ADA requirements. The total positions in this category include the conversion of 3 contract workers currently providing services in Planning and Development Services (3.00 FTEs).

- Internal Service Demands – The positions in this category are driven by a combination of internal and external customer service demands. The proposed budget includes 5.00 FTE positions at a net payroll and benefits cost of approximately \$0.3 million. The proposed budget adds staff in the City Attorney's Office (1.00 FTE), Financial Services (1.00 FTE) and Information Systems (1.00 FTE) and a new position to leverage sponsorship revenue and marketing opportunities (1.00 FTE). Out of the proposed 5.00 FTEs in this category, the budget includes the conversion of 1 contract worker currently providing services in Information Systems to a permanent full-time City position (1.00 FTE).

Transfers-Out – The FY 2005/06 proposed budget includes a \$32.7 million transfer to the CIP Fund for capital projects. A significant portion of the transfer out comes from non-recurring FY 2004/05 funding generated from greater than budgeted revenues and expenditure savings. Using these one-time funding sources for capital projects funding is prudent and does not jeopardize the General Fund's reserve or the projected FY 2005/06 year-end unreserved fund balance.

Fire Services - The proposed budget includes funding for the City's new municipal Fire Department scheduled to begin operations in July 2005. The total Fire Department budget is \$26.6 million and includes 257 positions approved by City Council on September 7, 2004. The positions were added in FY 2004/05 to accommodate required firefighter training prior to their July 2005 start date. In FY 2004/05 the City Council approved Fire Department enhancements beyond the current service levels, such as staffing levels (4th firefighter on a truck) and work hours (56 work week). The enhancements are reflected in this budget.

Culture and Tourism – The proposed budget includes a 3.0 percent increase for the Scottsdale Cultural Council contract and a 3.0 percent increase for the Scottsdale Convention and Visitors Bureau contract.

General Fund Balances and Reserves

The proposed FY 2005/06 budget includes the following:

General Fund Reserve – This reserve, projected to total \$28.4 million at the end of 2005/06, continues the City's financial policy of setting aside funds to protect Scottsdale in times of emergency. This is the City's "savings account." Most of these funds are carried over from previous years, and once they are spent, it will be extremely difficult to rebuild the reserve. It is financially prudent to have a minimum General Fund Reserve of \$28.4 million, an amount equal to 10 percent of annual total operating budget for the General and Transportation funds. For FY 2005/06 the proposed General Fund Reserve includes an additional \$4.0 million set aside in case the City must pay a settlement in an ongoing tax audit matter. Maintaining this reserve is very important to the municipal credit rating agencies and in retaining the City's triple AAA bond ratings.

Economic Investment – The proposed budget proposes \$5.0 million be set aside by the City Council for strategic economic vitality investments that demonstrate clear returns to the community.

Operating Contingency – The proposed budget includes a \$2.7 million operating contingency to meet unforeseen expenses during the year. This reserve is especially important in FY 2005/06, as we begin operating a municipal Fire Department. The contingency will allow the City more flexibility to meet any unforeseen costs.

Unreserved Fund Balance – After considering all of the other reserves, an unreserved fund balance of nearly \$5.0 million is projected at the end of the 2005/06 fiscal year. These funds are not designated for a specific purpose. The City Council may choose to allocate some or all of these dollars for new or expanded programs or requests, or to allocate them to other reserve funds. The unreserved fund balance represents a combination of accumulated one-time revenues and expenditure savings and would most appropriately be used for one-time expenditures, not to fund new or expanded programs with ongoing operating costs.

Special Revenue Funds

The City accounts for revenues earmarked for specific purposes – by law or City policy – through special revenue funds.

The Transportation Fund accounts for Highway User Revenues shared with cities from state "gas taxes." The fund also includes revenues from the .20 percent Transportation Privilege Sales Tax. The FY 2005/06 HURF revenues are expected to be approximately \$15.0 million, which is a modest increase of 2.0 percent, or \$0.3 million, over the forecasted FY 2004/05 year-end estimate of \$14.7 million. The Transportation Privilege Sales Tax revenue is projected to increase by 4.1 percent, or slightly more than \$0.7 million, to \$18.3 million in FY 2005/06. Local Transportation Assistance Fund revenue from the

Arizona State Lottery is expected to remain at the same level as 2004/05, about \$1.1 million. Transfers in to the Transportation Fund consist of \$3.1 million from the General Fund and \$.3 million from the Solid Waste Fund for alley maintenance costs.

The HURF revenues and 50 percent of the Transportation Sales Tax revenues cover the Transportation Fund operating expenditures and revenue bond debt service of \$28.6 million. The Transportation Department operating expenditures of \$13.1 million consist of master planning, transit services, traffic engineering and other operations. These revenues also support transportation improvements. The Municipal Services Department operating expenditures of \$12.4 million cover street and signal operations and maintenance. The revenue bond debt service is \$3.1 million. The remaining 50 percent of the Transportation Sales Tax, or \$9.2 million, is transferred to the Capital Improvement Plan for transportation related capital projects, under this proposed budget.

The proposed Transportation Fund budget includes the conversion of 7 contract workers to full time City employees with a nominal net fiscal impact.

Revenues and expenditures related the acquisition of the McDowell Sonoran Preserve are accounted for in the Preservation Privilege Tax Fund, which receives funding from the 1995 (0.20 percent) and 2004 (0.15 percent) voter-approved Preservation Privilege Tax initiatives. Total revenue from the 1995 Preservation Privilege Tax is expected to increase by \$0.7 million, or 4.1 percent, from \$18.1 million in FY 2004/05 to \$18.8 million in FY 2005/06. Revenue from the 2004 Preservation Privilege Tax is anticipated to increase by \$2.8 million, or 24.3 percent, to \$14.5 million. The large percentage increase between years is attributable to 11 months of tax collections in FY 2004/05, the initial year of the tax, compared to 12 months in FY 2005/06. Beyond FY 2005/06, the five-year financial plan projections reflect a stable 4.0 percent increase in sales taxes – keeping pace with inflation. Total expenditures and transfers-out of the fund are estimated at nearly \$39.4 million for FY 2005/06, compared to \$24.6 million in the current fiscal year. It is anticipated future preserve land will be purchased with debt proceeds. Under the sales tax ballot language the Preservation Privilege Tax revenues are to be used for debt service payments related to preserve acquisition, preserve-related construction and trailheads. The proposed budget assumes a planned issuance in the fall of 2005 of \$20.0 million in General Obligation Preserve Bonds. The bonds will provide funding for the City to move ahead on current preserve purchase plans and trailhead projects.

A collection of smaller restricted revenues for specific City services make-up the Special Programs Fund. The services included in these various funds are intended to be fully self-supporting and not subsidized by the General Fund. Examples of these funds include the Police Department RICO funds, the City Court's Court Enhancement Fund, the McCormick-Stillman Railroad Park Fund, the Scottsdale Cares Charitable Fund and the Preservation Rehab Fund for historic building rehabilitation.

Special Revenue Fund Budget Options for City Council Consideration

The Special Revenue for the Transportation Fund budget outlined above is based on the following change in the adopted Financial Policy recommended by the City staff for Council's consideration. The changes would apply to:

Transportation Sales Tax Allocation. The staff is recommending that the City Council modify the Transportation Sales Tax allocation from the current 60 percent for capital and 40 percent for operating purposes to 50 percent and 50 percent, respectively. This change would help to support the re-establishment of transit services that were reduced two years ago due to the economic downturn. This proposal is possible due to the passage of Proposition 400 in November 2004, which provides the City with increased regional transportation funding for operating and capital purposes.

Enterprise Funds

Enterprise funds account for the City's water, sewer, solid waste collection and aviation services, operated as stand-alone businesses. User fees are assessed to cover the full cost of services.

The Water and Sewer Fund budget continues to be significantly affected by Federal water quality mandates. The City is aggressively working to meet federal mandates to reduce arsenic levels in drinking water by January 24, 2006 and another forthcoming mandate to reduce levels of by-product compounds from chlorine disinfection. In this past year, the City began a pilot project to help determine the most effective method to meet federal standards. However, the Five-Year Financial Plan still anticipates the need to issue over \$100 million in debt to pay for the infrastructure to meet these mandates.

The budget includes a 3.5 percent water fee increase to help pay for these added costs. It also includes future debt of \$91.5 million, to be issued in March 2006, and an increase of 4.0 percent in sewer rates to fund modifications and upgrades to wastewater treatment facilities.

While the major costs of the Water and Sewer Fund are capital in nature, the proposed budget includes additional staff to support expanded water production facilities. The budget proposes 15 new FTEs, including the conversion of 1 part-time City employee to full time status. The estimated fiscal impact is about \$0.7 million.

The proposed FY 2005/06 Solid Waste Fund budget includes no fee increase for the operation of refuse collection and recycling services. The Solid Waste Fund is expected to maintain a positive fund balance over the five-year financial plan. The Solid Waste Fund budget proposes 4 new FTEs estimated at less than \$90,000 to maintain service levels for residential refuse and brush collection.

The proposed Aviation Fund budget includes no increase in landing fees in FY 2005/06. The five-year financial forecast for this fund projects continues to maintain a positive fund balance and there are no planned operating subsidies from the General Fund. The Aviation Fund budget proposes the conversion of 2 part-time part time City employees to full time status with net fiscal impact of \$31,000. The positions will provide additional security coverage.

Internal Service Funds

Internal Service Funds account for services and equipment provided to all City departments by centralized divisions, such as maintenance of the City's vehicle fleet and insurance coverage.

The proposed Self-Insurance Fund budget assumes total revenue and transfers-in of \$21.5 million. The proposed budget anticipates total operating and claims expenditures and transfers-out of \$22.1 million in FY 2005/06. The projected ending fund balance reserve is \$13.9 million for property casualty, \$0.1 million for short-term disability, and \$6.6 million for health benefits. With the addition of a municipal Fire Department in FY 2005/06 and the City's move to self-insurance, solid reserves are essential to the fiscal stability of the plans. The Self-Insurance Fund budget proposes the conversion of 1 part-time contract worker to a full-time City employee with a net fiscal impact of less than \$20,000.

The proposed Fleet Management Fund forecasts \$12.7 million in total revenues and \$12.1 million in expenditures and transfers out. The expenditures and transfers out include \$3.4 million for vehicle and equipment acquisitions and nearly \$8.5 million for fleet operations. Additionally, the budget includes approximately \$0.1 million to cover the initial costs associated with the staggered hiring of one crew chief and four equipment mechanics starting in February 2006. After considering all of the proposed acquisitions and operating impacts, the proposed five-year financial plan for the Fleet Management Fund continues to maintain a fiscally responsible fleet replacement reserve.

Debt Service Fund

Debt service funds are designated for payment of long-term debt not directly paid through the General, Enterprise or Special Revenue funds.

Total revenues and transfers-in to these funds are estimated at \$53.6 million for FY 2005/06, compared to \$57.5 million for FY 2004/05. A total of \$53.4 million is planned for debt service payments in FY 2005/06.

Property taxes levied to pay for voter-approved bonds are the largest revenue source in this fund and are expected to provide \$26.9 million in FY 2005/06. The proposed budget projects the rate for "secondary" property taxes, the portion of property taxes specifically dedicated for bonds, will drop 5 cents from 62 cents to 57 cents per \$100 valuation. This is the eighth consecutive year of a drop in the property tax rate.

The debt service also includes \$20.6 million for preserve-related bonds, \$1.1 million for special assessment debt and \$4.8 million for MPC bonds.

Debt service funds also receive revenue from special district assessments and pay for special district debt service. The remaining revenues in these funds are from interest earnings and miscellaneous sources.

The budget assumes a planned issuance in the fall of 2005 of \$125.0 million in General Obligation Bonds. The bonds proceeds will provide funding for voter approved Bond 2000 capital projects such as libraries and parks, neighborhood flood mitigation, scenic corridors, public safety, and transportation .

Conclusion

The information provided in this proposal provides the basis for a comprehensive discussion of the proposed budget over the next few months, when the City Council and the public will have the opportunity to gain more insight into the budget development process and the City's financial picture.

The primary goals of this challenging budget development process have been to:

- Use conservative and realistic revenue forecasts.

- Limit staff increases to high priority service areas and redeploy existing staff, where possible.
- Use a zero-based program budget approach to justify and control expenditures while still focusing on achieving the City Council's Broad Goals and providing basic City services.
- Focus on continuing high priority programs and eliminate or reduce funding to less critical programs.
- Continue to fund needed investment in the City's infrastructure and facilities.
- Continue to plan for the future through the astute use of City resources for strategic economic development investments that demonstrate a clear return to the community.
- Maintain a prudent level of financial reserves.

It is appropriate to thank the City staff, especially Chief Financial Officer Craig Clifford, Budget Director Art Rullo and the entire Financial Services staff, who have put much time and expertise into the development of the proposed budget and balanced Five-Year Financial Plan. The staff has been working on this document since adoption of the FY 2004/05 City Budget, when the first steps of this budget review process began. Departments have worked closely with the Financial Services staff and senior management in developing, documenting and reviewing every component of this proposal. The staff has embraced the City Council's Goals in building a financial plan that delivers the highest quality services at the most reasonable cost to the residents and businesses of Scottsdale.

Citizens already have met with the members of the City Council Budget Subcommittee and the staff to discuss budget priorities for the coming year, and many of their insights have been incorporated in the proposed budget. Over the coming weeks, the subcommittee and citizens will devote many more hours to understand and analyze the proposed budget and offer their perspectives. Their input is an important part of the budget development process.

The City Council is scheduled to begin its formal review of the budget on April 12, when the staff will present the proposed budget. On April 26, the Budget Subcommittee will present their recommendation to the full City Council regarding the proposed budget. The City Council is scheduled to hold the first public budget hearing on May 3, adopt a tentative budget on May 17 and adopt the final budget on June 7, 2005.

The City staff and I look forward to a thorough and thoughtful examination of the FY 2005/06 proposed budget.

Janet M. Dolan
City Manager